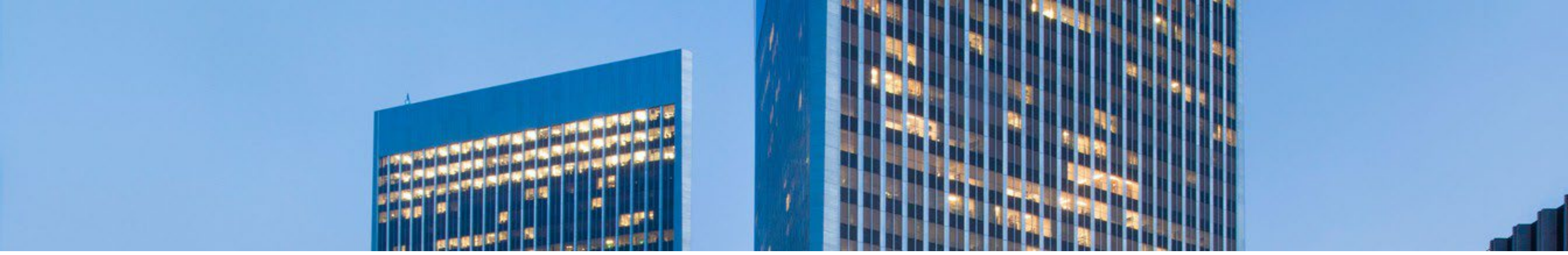

NEW CASE GIVES ROADMAP FOR AVOIDING SELF-EMPLOYMENT TAX

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1. Overview. On January 16, 2026, the Fifth Circuit, in *Sirius Solutions L.L.L.P. v. Commissioner*[1] ("*Sirius*"), reversed the Tax Court and held (in a 2-1 decision) that partners with limited liability are not subject to self-employment tax on their allocable share of the partnership's business income, even if the income is attributable to the partners' active services. *Sirius* applies to both the regular 12.4% Social Security tax and the additional 3.8% Medicare tax. *Sirius* reached this conclusion based on a plain reading of an exclusion from self-employment income under IRC §1402(a)(13) (the "Exclusion"), which states (emphasis added):

> *There shall be excluded [from self-employment income] the distributive share of any item of income or loss of a limited partner*, as such, other than guaranteed payments described in section 707(c) to that partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services.

For many years, the IRS has taken the position that the Exclusion does not apply to partners who render services to the partnership, and since 2011 the Tax Court has upheld the IRS position in three cases.[2] *Sirius* is thus critically important, as it is the first appellate court case to consider the issue. In 2022, the IRS issued tax form instructions confirming its position. However, the court in *Sirius* relied on the recent Supreme Court case of *Loper Bright*,[3] which held that courts "must exercise independent judgment in determining the meaning of statutory provisions," and if a statute is clear on its face, the courts should disregard any agency interpretation that contradicts it.

2. "Limited Partners". The Exclusion applies to "limited partners," but the *Sirius* case did not involve a classic limited partnership; it dealt with a "limited liability limited partnership" under Texas law. The court in *Sirius* expressly declined to address other entities, such as limited liability companies (an "LLC") or professional limited liability partnerships (an "LLP"), but it repeatedly emphasized that a "limited partner" is simply a partner who is not liable for the debts of the partnership: "limited partner requires limited liability." Thus, *Sirius* should apply to any owner of an entity that is treated as a partnership for tax purposes if the owner is not liable for the debts of the entity, including (a) a limited partnership, (b) an LLC, and (c) an LLP. However, the determination may also turn on state law and the particular facts: For example, some states (including Delaware and California) make a limited partner liable for certain debts of a limited partnership if they "participate in control of the business," and some states (including California), make the partners of an LLP liable for certain debts of the LLP if it does not maintain a specified level of insurance.[4]

3. "Partnership". For the Exclusion to apply, the entity must be a partnership for tax purposes.[5] An LLC will therefore qualify as long as the LLC has two or more members and has not elected to be taxed as a corporation. An LLC with a single individual owner

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would not qualify, so such entities should consider giving at least a 1% interest to a new member. If an LLC is owned by spouses, they can elect to treat the LLC as a partnership,[6] and doing so would permit them to rely on *Sirius*.

4. Excluded Income. The Exclusion only applies to income that would otherwise be subject to self-employment tax. Thus, rents and investment income are not subject to the Exclusion and may be subject to a separate 3.8% tax on "net investment income."

5. Guaranteed Payments. The Exclusion does not apply to "guaranteed payments" for services under IRC §707(c), which applies to payments for services if the payments are "determined *without regard to the income* of the partnership." *Pratt v. Commissioner*[7] held that payments based on a percentage of gross income are not guaranteed payments because they *are* determined with reference to the income of the partnership. Thus, a payment to a partner that is a percentage of collections is not a "guaranteed payment." There are proposed regulations that would treat gross income allocations as guaranteed payments, but they were never finalized and thus don't apply. In contrast, minimum base compensation should be a "guaranteed payment."

6. Future Cases. Given (a) the clear wording of IRC §1402(a)(13), (b) the admonition of the Supreme Court in *Loper Bright* for courts to ignore agency interpretations that contradict the clear wording of a statute, and (c) the holding in *Sirius*, it seems likely that future appellate courts will likewise hold that IRC §1402(a)(13) means what it says, and that it is up to Congress, not the courts, to change the statutory language. The Tax Court is now bound by *Sirius* for cases in the Fifth Circuit but is not bound by *Sirius* in other circuits. If the Tax Court continues to follow its earlier precedent outside the Fifth Circuit, taxpayers that lose in Tax Court will need to appeal. Nevertheless, given the underlying reasoning in *Sirius*, it would appear likely that taxpayers will prevail. If a circuit split does develop, it also seems likely that the Supreme Court will side with *Sirius*.

7. Disclosure. One key issue is whether taxpayers should disclose reliance on *Sirius* on Form 8275 on future tax returns in order to avoid penalties in case they lose in Tax Court and on appeal. Under IRC §6662, a 20% penalty can be imposed for an understatement of tax that is due to (as applicable here) either (a) negligence, (b) disregard of "rules or regulations," or (c) an understatement of tax of over $5,000 if it is not supported by "substantial authority." The IRS tax form instructions on this issue do not constitute a "rule or regulation,"[8] the *Sirius* case is "substantial authority," and disclosure does not avoid the penalty if the court rules that the taxpayer was negligent for not following the IRS position as stated in the tax return instructions. The net result is that there is no reason to file a disclosure statement with a return that relies on *Sirius* as long as the K-1 issued to the taxpayer follows *Sirius.* If the K-1 does not follow *Sirius*, the taxpayer should file a Form 8082 to disclose the inconsistency.

8. Amending Prior Returns. Another key issue is whether it is worth amending prior returns that are open under the three-year statute of limitations. It is definitely worth doing so for taxpayers in the Fifth Circuit, because the Tax Court *must* follow the *Sirius* decision

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in that circuit. For taxpayers outside the Fifth Circuit, (a) the IRS is almost certain to deny a refund request, (b) the taxpayer will thus have to fight the issue in court, and (c) most importantly, an amended return often triggers an audit. It may therefore not be worth amending prior returns for taxpayers not in the Fifth Circuit. In any case, the decision on whether to file an amend tax return should be made in consultation with your tax advisor.

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[1] *Sirius Solutions, L.L.L.P., et al. v. Commissioner of Internal Revenue*, No. 24-60240 (5th Cir.).

[2] *Renkemeyer, Campbell & Weaver, LLP v. Commissioner*, 136 T.C. 137 (2011); *Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (2023); *Denham Capital Management LP v. Commissioner*, T.C. Memo. 2024-114 (2024).

[3] *Loper Bright Enters. v. Raimondo*, 603 U.S. 369 (2024).

[4] California Corporations Code §16956.

[5] IRC §7701(a)(2); *Joseph v. Commissioner*, T.C. Memo 2020-65 (U.S. Tax Ct. 2020).

[6] Rev. Proc. 2002-69, 2002-2 C.B. 831 (Oct. 9, 2002).

[7] *Pratt v. Commissioner*, 64 T.C. 203 (1975), aff'd on this issue, 550 F.2d 1023 (5th Cir. 1977).

[8] Treas. Reg. §1.6662-3(b)(2).